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northwest economic
indicators
NORTHWESTERN NATIONAL BANK OF MINNEAPOLIS AN AFFILIATE OF NORTHWEST BANCORPORATION

Fall 1979 Regional Economic Survey

November 13, 1979

Highlights

- **Despite a rebound in economic activity during the third quarter of this year, increasing numbers of Twin Cities bankers are braced for a recession. Over 40 percent of the bankers in the metropolitan area are expecting economic conditions to deteriorate during the next six months, sending the confidence index for the Twin Cities to its lowest level since this survey began. Pessimism also prevails among Minnesota Iron Range bankers, a sharp reversal of attitudes since last April.**
- **In contrast, agricultural bankers in the Upper Midwest expect their communities will be spared the impact of a national economic down turn. Some farmers are benefiting from the best of all worlds: record crops and higher prices. Over half of the agricultural bankers expect a continuation of current favorable conditions; another 23 percent anticipate improvement in economic conditions. The economic outlook, however, is much more subdued in the western portions of Montana and South Dakota where very poor moisture conditions prevail.**
- **Interest rates continued their steep climb at Twin Cities and Iron Range banks reflecting heavy loan demand, tighter monetary policy and sharp increases in costs of deposits and purchased funds. While still lagging behind rates in nonfarm areas, interest rates charged by agricultural banks have also risen sharply. The recent credit tightening by the Federal Reserve is causing agricultural bankers to ration credit based on the purpose of the loans as interest rates in some states are bumping up against usery limits, especially those for smaller-sized borrowers.**
- **Loan-to-deposit ratios at agricultural banks are at an all-time high as deposits have not kept pace with the surge in loan demand. About one-third of the agricultural bankers said they turned down loan requests due to lack of funds and nearly half were less active in seeking new customers. The largest jump in loan-to-deposit ratios occurred in Minnesota and the Dakotas where significant numbers of bankers indicated that transportation problems and the grain handlers strike in Duluth had a severe affect on the availability of loan funds.**
- **Agricultural bankers anticipate continued strong growth in farm loan volume over the next year. Loans for crop operating expenses are expected to increase the most due to escalating production costs and increased crop acreage in 1980. Heavy loan demand will keep pressure on agricultural bank liquidity, although increased marketing of grain should help ease liquidity pressures. However, agricultural bankers feel that grain transportation bottlenecks will continue to plague agriculture in this region.**
- **Record interest rates and a faltering economy are expected to dampen the growth of loan demand in the Twin Cities during the next six months. Home mortgages are expected to show the greatest weakness. Even greater softening of loan demand is expected in the Iron Range area.**

Dr. Sung Won Son
Senior Vice President and
Chief Economist

Economic Outlook

Our seventh semi-annual survey of Upper Midwest bankers reveals considerable differences in the economic outlook for the farm and non-farm segments of this region's economy. Fading optimism in the Twin Cities area over the past year and a half has now turned to pessimism. The confidence index for the Twin Cities fell to its lowest level since the survey began three years ago. Over 40 percent of Twin Cities bankers expect economic conditions to deteriorate during the next six months, while only 12 percent expect conditions to improve.

Although Twin Cities bankers appear to be braced for a recession, they expect the local economy to be less severely affected than the national economy.

Pessimism also prevails in the Minnesota Iron Range area. About 46 percent of the Iron Range bankers expect economic conditions to become worse over the next six months; only 15 percent feel conditions will improve. This is a sharp change in attitudes since our survey this past April when nearly 40 percent of the Iron Range bankers expected economic conditions would improve.

The survey also reveals that agricultural bankers in the Upper Midwest are not fearful of a recession. Over 50 percent of the agricultural bankers expect the current favorable economic conditions to continue. Another 23 percent expect economic conditions will improve. The outlook, however, is more subdued in the western parts of Montana and South

Dakota where half of the bankers expect economic conditions to deteriorate during the next six months. This attitude in part reflects the very poor moisture conditions prevailing in that portion of the country.

This picture emerges from survey responses from about 650 bankers located in the Twin Cities, Minnesota's Iron Range and agricultural communities in Iowa, Minnesota, Montana, Nebraska, North and South Dakota and western Wisconsin. The survey was conducted in early October.

In the following discussion, banks in the Twin Cities and Iron Range areas are referred to as "metro banks" and banks in the other areas of the seven-state Upper Midwest region are referred to as "agricultural banks".

Business Conditions

Retail Sales: The survey provides evidence that the growth of retail sales is slowing in the metro region. While 30 percent of the Twin Cities bankers indicated that retail sales are better than a year ago, over half felt retail sales are about the same as last year. This is the smallest amount of improvement reported since the survey began. Retail sales appear to be even more sluggish in the Iron Range area.

Despite sales promotions and cash rebates, over 60 percent of the metro bankers reported a drop in auto sales during the past 12 months. Metro bankers indicate that major household appliance sales also show definite signs of softness. Even so, the worst is yet to come. On the bright side, the majority of metro bankers report little change in retail inventories during the past year, suggesting that retailers have been successful in preventing undue accumulation of inventories.

The majority of agricultural bankers indicate that retail sales are about the same as one year ago, however, their responses vary considerably by area. Retail sales are the least robust in western South Dakota and the Red River Valley areas of Minnesota and North Dakota where 40 percent of the bankers felt retail sales are worse than last year. This decline reflects the impact of the grain strike in Duluth, various weather related problems and the more modest improvement in farm income reported for those sections of the region. The survey also reveals that auto and truck sales are generally weak throughout the agricultural communities in the seven-state region.

Housing: Rapidly rising prices and high interest rates have taken a definite toll on the housing market. Over half of the Iron Range banks and nearly 70 of Twin Cities banks report lower housing starts compared to a year ago. In addition, practically all Twin Cities bankers reported that existing homes are selling at a slower pace than a year ago. Existing homes sales are also weak in the Iron Range area.

The Federal Reserve's new monetary policy is expected to have a serious impact on the housing industry. Besides higher mortgage rates, reduced availability of funds will cut increased numbers of home buyers out of the market. A number of lenders in the Twin Cities area already have, at least temporarily, withdrawn from the mortgage market due to lack of funds.

The recent change in Minnesota's usury law will prevent mortgage money from drying up completely. Nevertheless, savings outflows from financial institutions have reduced the availability of mortgage money. In addition, due to the jump in interest rates sought by investors, lenders are less able to sell mortgages from their portfolios in the secondary market and thereby free up additional mortgage funds.

Capital Expenditures: The pattern of capital spending varies considerably throughout our region. In the Twin Cities, capital expenditures on plant and equipment are reported to be holding up better than consumer expenditures. In contrast, over 60 percent of the Iron Range bankers report declines in capital expenditures, reflecting the end of a major construction boom in the taconite industry.

Agricultural bankers indicate that although capital outlays remain fairly strong, expenditures on machinery and equipment are not as robust as six months ago. The strongest growth was reported in Wisconsin. On the other hand, substantial deacceleration in spending was noticed in the Minnesota Red River Valley, North Dakota and eastern Montana.

Part of this weakness is related to the difficulties farmers encountered in selling grain this past summer. Some bankers report that farmers are continuing to postpone machinery and equipment purchases in response to tighter credit conditions, rising interest costs and unresolved transportation problems.

Farm Income: Over half of the agricultural bankers indicate that farm income is higher than last year's favorable level. In a number of areas farmers are benefiting from the best of all worlds: record crops and, thanks to strong export demand, higher prices. Income of dairy farmers in Wisconsin and cow-calf operators in Montana have also improved significantly due to favorable prices. Inflation, however, makes the rise less spectacular in real terms.

The smallest income gains were reported for the Red River Valley and western South Dakota.

Credit Conditions

Cost of Credit: Interest rates have continued their steep climb. During the past year, the average lending rate charged for working capital loans rose by 2.6 percentage points at Twin Cities banks, reaching 13.26 percent in early October. During the same period interest rates for working capital loans rose by 2.44 percentage points to 13.15 percent at Iron Range banks. The new stringent monetary policy actions by the Federal Reserve (Fed) has pushed interest rates even higher.

In the past, interest rates charged by most agricultural banks have not been set up to follow money market rates. Recently, this tendency appears to be breaking down as the cost of funds has shot up dramatically. While still lagging behind rates in nonfarm areas, interest rates charged by agricultural banks have risen sharply.

During the past year, the average lending rate charged by agricultural banks for farm operating loans jumped by over two percentage points reaching 11.38 percent in early October. And rates have continued to rise due to the recent credit tightening by the Fed. This is causing bankers to ration credit

based on the purpose of the loans as interest rates are bumping up against usury ceilings, especially those for smaller-sized borrowers, in states such as Iowa and South Dakota.

Lending rates have risen in response to strong loan demand, liquidity pressures, increased costs of purchased funds as the Federal Reserve tightened credit conditions and higher rates paid on deposits including a shift towards money market certificates. More than half of the agricultural bankers said that six month money market certificates comprise over 10 percent of their consumer time deposits. Just one year ago these money market certificates accounted for less than 5 percent of the time deposits at nearly all agricultural banks. This shift towards more costly deposits has also occurred at metro banks.

Availability of Credit: After showing a sharp increase this past spring, the average loan-to-deposit ratio at Twin Cities banks has stabilized at 68.7 percent. Nevertheless, the survey results suggest that credit conditions are tight. Over 90 percent of Twin Cities banks said their loan demand was higher than a year ago. Moreover, during the past six months, over two-fifths of the bankers stated that they denied loan applications due to lack of funds. A significant number of these loan applications are likely to have been for home mortgages. The same number of bankers said they were less active than normal in seeking new loan accounts. They also relied more heavily on purchasing Fed funds to meet their rising loan demand.

Iron Range banks also experienced tighter liquidity. Over 90 percent of the banks reported higher loan volume compared to a year earlier, while only 40 percent indicated that their demand deposits were higher. As a result the average loan-to-deposit ratio increased to 71.4 percent, up 0.54 percentage points in the past six months and 2.35 points in the past year. About 45 percent of the banks reported ratios of 75 percent or larger.

As was the case for Twin Cities banks, 40 percent of the Iron Range banks indicated they denied a larger than normal number of loan requests due to lack of funds and that they were less active in seeking new customers. The

REGIONAL ECONOMIC SURVEY SUMMARY TABLE
FALL 1979

BUSINESS CONDITIONS*

(1) Is **farm income** higher or lower than it was a year ago?

	Higher	About the Same	Lower
Ag Banks	54%	36%	10%

(2) Are **retail sales** better or worse than they were a year ago?

	Better	About the Same	Worse
Ag Banks	21%	61%	18%
Twin City Banks	32%	53%	15%
Iron Range Banks	31%	46%	23%

(3) Are farmers (local businessmen) making more or less **capital expenditures** (such as buildings, machinery, and other farm and business equipment) than a year ago?

	More	About the Same	Less
Ag Banks	27%	51%	22%
Twin City Banks	20%	56%	24%
Iron Range Banks	8%	31%	61%

(4) Are **land prices** higher or lower than a year ago?

	Higher	About the Same	Lower
Ag Banks	75%	25%	0%

(5) Do you think the **overall economic condition** in your area will be better or worse six months from now?

	Better	About the Same	Worse
Ag Banks	23%	54%	23%
Twin City Banks	12%	45%	43%
Iron Range Banks	15%	39%	46%

CREDIT CONDITIONS

(6) Are your customers **repaying loans** at a faster or slower rate than they did a year ago?

	Faster	About the Same	Slower
Ag Banks	5%	56%	38%
Twin City Banks	2%	74%	24%
Iron Range Banks	0%	62%	38%

(7) In the past six months did your bank **deny loan requests** due to lack of funds?

	More Than Normal	No More Than Normal	Less Than Normal
Ag Banks	33%	61%	6%
Twin City Banks	41%	44%	15%
Iron Range Banks	38%	38%	23%

(8) What impact did **transportation problems** and the **grain handlers strike** have on loan funds availability?

	Little	Moderate	Severe
Ag Banks:			
Minn. Red River Valley	0%	50%	50%
South Dakota	26%	40%	34%
North Dakota	7%	38%	55%

(9) Do you think your **loan demand** will be higher or lower six months from now?

	Higher	About the Same	Lower
Ag Banks	77%	21%	1%
Twin City Banks	39%	39%	22%
Iron Range Banks	31%	38%	31%

AGRICULTURAL CONDITIONS

(10) What are the present **subsoil moisture conditions** in your area?

	Above Normal	Normal	Below Normal
Ag Banks	31%	38%	31%

(11) What changes do you expect in **beef cattle breeding herds** in your area in 1980?

	Increase	No Change	Decrease
Ag Banks	40%	57%	3%

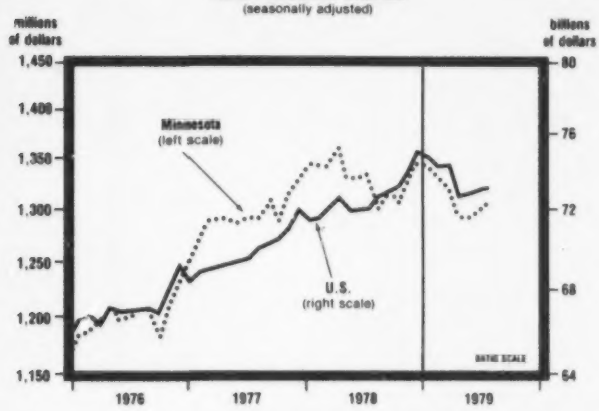
(12) Excluding grain still under CCC loan, are farmers **holding more or less grain** than they did a year ago?

	More	Same	Less
Ag Banks	58%	36%	6%

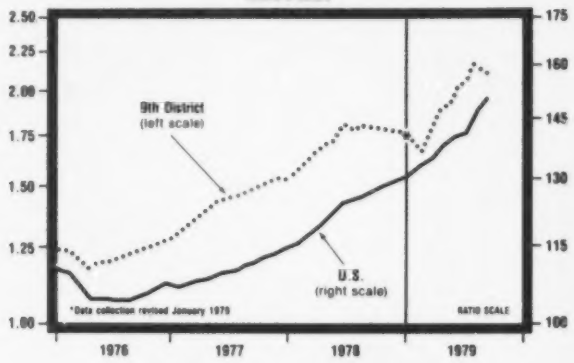
*Data show proporation of bankers falling in each of the categories higher, same, lower, etc.

REGIONAL ECONOMIC CONDITIONS

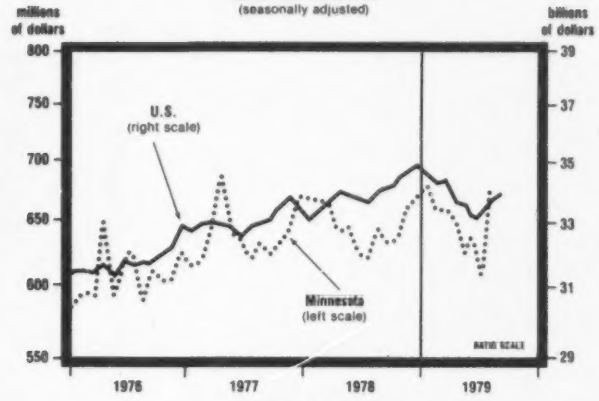
REAL PERSONAL INCOME
(seasonally adjusted)



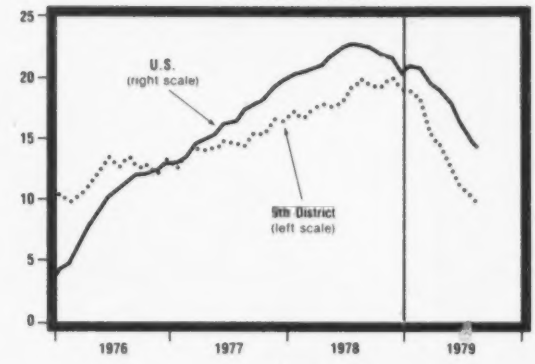
COMMERCIAL AND INDUSTRIAL LOANS
OUTSTANDING AT LARGE COMMERCIAL BANKS
(seasonally adjusted)
billions of dollars



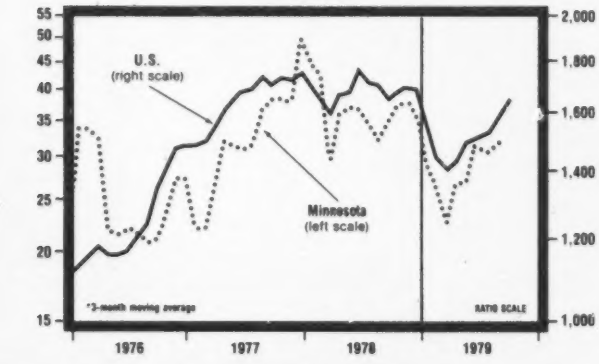
REAL RETAIL SALES
(seasonally adjusted)



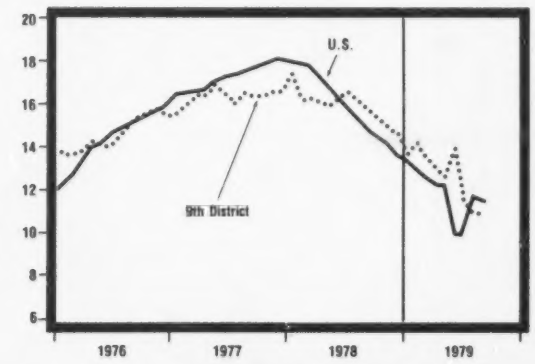
CONSUMER INSTALLMENT CREDIT
OUTSTANDING AT COMMERCIAL BANKS
percent change from a year ago



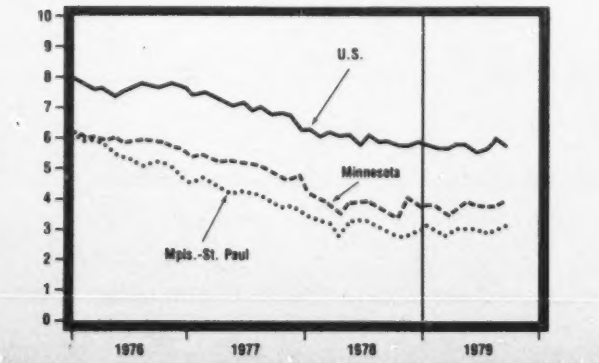
HOUSING PERMITS
HOUSING UNITS AUTHORIZED BY BUILDING PERMITS
(seasonally adjusted annual rates*)
thousands of units



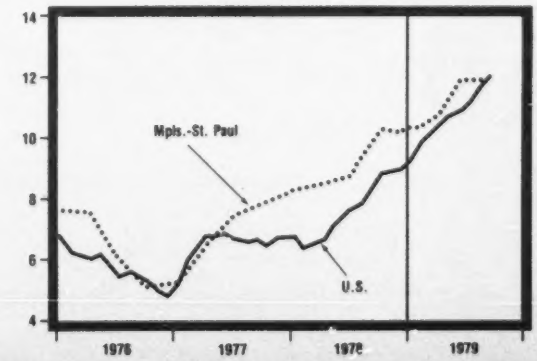
MORTGAGE LOANS
OUTSTANDING AT SAVINGS AND LOAN ASSOCIATIONS
percent change from a year ago



UNEMPLOYMENT RATES
(seasonally adjusted)
percent of labor force

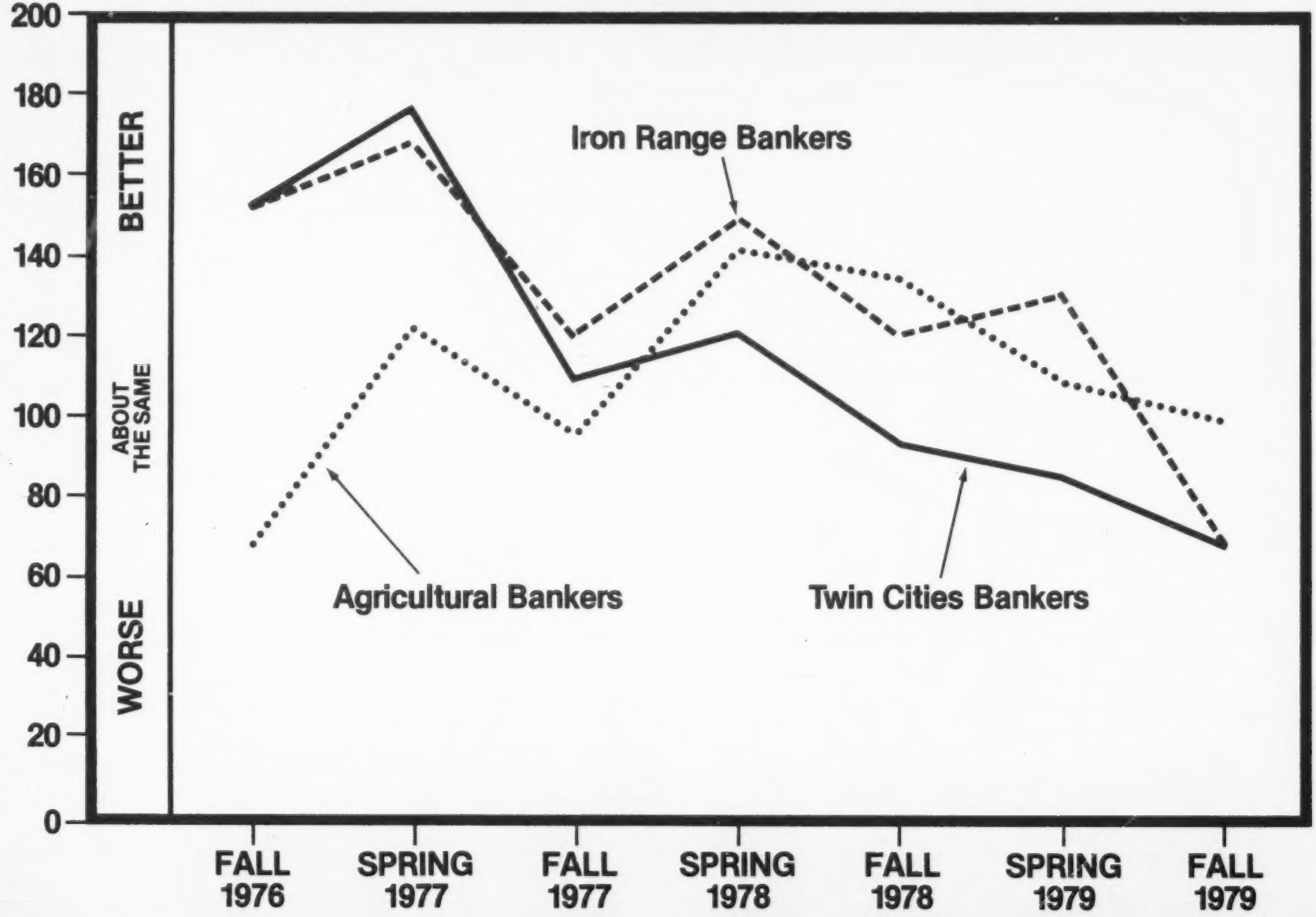


CONSUMER PRICE INDEX
ALL ITEMS, ALL URBAN CONSUMERS
percent change from a year ago



UPPER MIDWEST CONFIDENCE INDEX

Percent of bankers expecting economic conditions to improve
minus percent expecting conditions to deteriorate during the next six months plus 100.



survey results also reveal a definite slowdown in loan repayment rates.

In the farm communities, loan demand continued to out-distance the growth of demand deposits. Accordingly, the loan-to-deposit ratios at agricultural banks are at an all-time high and are likely to go higher. Even so, the quality of agricultural loans appears to be good. The loan-to-deposit ratio averaged 68.9 percent at agricultural banks, up 4 percentage points in the past 12 months. One-third of the agricultural banks had ratios of 75 percent or more. Just three years ago, the loan-to-deposit ratio averaged 57.5 percent for agricultural banks.

Among the seven states surveyed, the average loan-to-deposit ratio ranged from 66.7 percent in Iowa to 73.3 percent in Wisconsin. The greatest increase in this ratio occurred in the Dakotas (up more than 6 percentage points) and in Minnesota (up 4 percentage points); grain transportation problems and the grain handlers strike in Duluth affected these areas the most. A significant number of bankers in the Dakotas and the Minnesota Red River Valley indicated that transportation problems and the grain handlers strike had a severe affect on the availability of loan funds.

Further evidence of tight credit conditions is obtained from reports that about one-third of the agricultural banks turned down loan requests due to lack of funds. In addition, nearly 50 percent were less active in seeking new customers and over 40 percent relied more heavily on purchasing Fed funds.

Future Loan Demand: As a result of the current high interest rates and the anticipated downturn in the local economy, Twin Cities bankers expect loan volume to grow at a more moderate pace during the next six months. Home mortgages are expected to show the greatest weakness. While moderating somewhat, commercial and industrial loan demand is expected to remain relatively strong.

Bankers feel that loan demand will weaken even more in the Iron Range area during the next six months. Over 50 percent of the Iron Range bankers expect mortgage loan demand to decline and nearly that number anticipate a decline in commercial and industrial loan volume.

In contrast, the strong agricultural loan demand is projected to continue, with 77 percent of the bankers expecting higher loan volume a year from now. Although bankers feel that all areas of loan demand will remain strong, loans for crop operating expenses are expected to increase the most. This reflects escalating crop production costs, especially for fuel and fertilizer, as well as increased crop acreage next year due to the elimination of set-aside requirements for wheat and feed grains.

Other areas of continued strong loan demand include livestock, machinery and equipment, and crop inventories. The projected heavy loan demand will keep pressure on agricultural bank liquidity, although increased marketing of grain should help ease liquidity pressures.

Agricultural Conditions

Moisture Conditions: Subsoil moisture conditions are highly variable throughout the seven state region. Nearly 100 percent of the bankers in Montana reported below normal subsoil moisture. This caused germination problems for winter wheat and rye. Below normal moisture conditions were also reported in western South Dakota and parts of North Dakota. On the other hand, above normal subsoil moisture conditions exist in south-central Minnesota and Iowa.

Grain Storage: Despite higher grain prices this past summer, nearly 60 percent of the agricultural bankers report that farmers are holding more grain than a year ago. Increased holdings of grain are especially evident in eastern South Dakota, North Dakota and the Minnesota Red River Valley. This reflects the impact of the 11-week strike at the Port of Duluth, the independent truckers strike and other transportation bottlenecks. Bankers in these same areas indicate that the grain handlers strike and transportation problems had a serious negative impact on grain prices and storage capacity. Other parts of the 7-state region were less severely impacted.

1980 Crop Acreage: Bankers do not anticipate any major shifts in crop production next year. Wheat, corn and soybean acreage are all expected to rise as idled-acres are brought back into production. The outlook for soybeans could be altered depending on price trends before the planting season. Slight reductions are anticipated in small grain acreage, while sunflower acreage is expected to continue to expand in 1980.

Livestock: Bankers expect beef prices to increase during the next six months as a result of the smaller number of cattle reported on feed. In 1980, ranchers are expected to respond to favorable feeder cattle prices by increasing their beef breeding herds. However, it will be quite some time before increased supplies show up on the dinner table.

Due to sharp increases in hog production, bankers expect pork prices to remain at the unprofitable levels which existed during early October. Despite these low prices, agricultural bankers expect little change in hog breeding herds during the next six months.

Dr. Larry J. Wipf
Senior Economist

Northwestern National Bank of Minneapolis
Seventh & Marquette
Minneapolis, Minnesota 55480
An Affiliate of Northwest Bancorporation
BANCO

Indicators is a publication of Northwestern National Bank of Minneapolis Economics Department. For further information contact Dr. Sung Won Son, Chief Economist, (612) 372-7871; Dr. Larry J. Wipf, Senior Economist, (612) 372-9281; Dr. Richard S. Smith, Senior Economist, (612) 372-5857; or Lola Johnson, Communications, (612) 372-8027.